

A Timely Fix: Interest Rate Options For Your Investment Loan

CommSec
Adviser Services



When you borrow to invest, the amount of interest you pay on your loan can affect your cash flow, and influence the effectiveness of your investment strategy. So it's only natural you want to make the right decision when it comes to choosing fixed or variable interest rates.

Should you fix, and get the certainty of knowing exactly what you'll be paying each month? Or should you choose variable and hope that interest rates drop – potentially leaving you better off than if you 'locked in' a higher rate?

As the end of the financial year approaches, it's worth discussing your options with your financial adviser. You may find there are some valuable tax benefits associated with fixing the interest rate on some or all of your investment loan before 30 June.

Introducing James and Elizabeth

James and Elizabeth are long-term investors who have been using a CommSec Adviser Services Investment Loan for a number of years. They have a \$100,000 loan balance, and have always operated their investment loan under a variable interest rate. In more recent times they have become conscious of the fluctuations in interest rates, and how this may impact their overall interest costs. They would like to know more about how they can lock in their interest costs.

To get some answers, James and Elizabeth decide to speak to their financial adviser, who shows them three ways they can incorporate fixed interest rate options into their portfolio.

1. Fix their interest rate, and prepay their interest costs annually
2. Fix their interest rate, and pay their interest costs monthly
3. Fix part of their loan, and prepay some of their interest costs annually



James and Elizabeth, Investors

POTENTIAL TO CLAIM NEXT YEAR'S INTEREST IN THIS YEAR'S TAX RETURN

One of the benefits of fixing the interest rate on an investment loan is that it gives you the ability to prepay interest – meaning you may be able to claim next year's interest costs as a tax deduction this financial year. Read on to see how it works.

Strategy 1

Fix their interest rate, and prepay their interest costs annually

This option allows James and Elizabeth to lock in their interest rate for a period of as little as one year, or up to five years. Instead of paying interest monthly in arrears as they are currently, they will pay one year's interest in advance on each anniversary of their fixed loan.

The benefit of this option is that it allows James and Elizabeth to bring forward an expense that may otherwise be tax-deductible in the following financial year.

What's more, James and Elizabeth will have already paid 12 months' interest at the variable interest rate during the current financial year. That means they could potentially claim up to 24 months of interest in the current financial year if they prepay the next 12 months' interest by 30 June.

Strategy snapshot

	Before strategy	After strategy
Interest claimed as tax deduction this financial year	12 months (all variable)	24 months, consisting of: <ul style="list-style-type: none"> ▶ 12 months variable interest, paid monthly in arrears ▶ 12 months fixed interest, paid annually in advance
Lump sum payment required before 30 June	None	12 months fixed interest
Interest payments next financial year	Monthly, variable interest rate	None. However, if the fixed rate loan continues beyond next year, they can adopt a similar strategy and pay their fixed interest in advance before 30 June next year

Advantages

- ▶ Interest rate certainty
- ▶ May bring tax deduction forward to current financial year (if paid prior to 30 June)
- ▶ May allow you to claim up to 24 months of interest payments as a tax deduction this financial year if switching from variable to fixed
- ▶ Fixed interest rate may be lower than current variable rate

Disadvantages

- ▶ Requires a lump sum interest payment (Note: you may be able to capitalise this amount to your loan so there's no cash required)
- ▶ Fixed interest rate may be higher than current variable rate
- ▶ Break fees may apply if fixed loan is broken early

Strategy 2

Fix their interest rate, and pay their interest costs monthly

Like Strategy 1, this option allows James and Elizabeth to lock in their interest rate for a period of as little as one year, or up to five years.

The difference is that it allows them to continue making interest payments each month – similar to their current arrangement on the variable interest rate.

The benefit of this strategy is that no upfront payment of interest is required, and they will know with certainty the amount of interest they will be required to pay during the period they choose to fix their interest rate.

Strategy snapshot

	Before strategy	After strategy
Interest claimed as tax deduction this financial year	12 months (all variable)	12 months (all variable)
Lump sum payment required before 30 June	None	None
Interest payments next financial year	Monthly, variable interest rate	Monthly, fixed interest rate

Advantages

- ▶ Interest rate certainty
- ▶ Regular monthly repayments for improved cash flow management
- ▶ Fixed interest rate may be lower than current variable rate

Disadvantages

- ▶ Cannot bring forward tax deduction
- ▶ Fixed interest rate may be higher than current variable rate
- ▶ Break fees may apply if fixed loan is broken early

Strategy 3

Fix part of their loan, and prepay some of their interest costs annually

A CommSec Adviser Services Investment is flexible enough to allow borrowers to split their current loan balance into any combination of the previous two interest rate options. This could be particularly useful if you want to ‘hedge your bets’ on interest rate movements, or if you want to reduce the lump sum prepayment required at year-end.

For example, James and Elizabeth are keen to prepay some of their interest costs before the end of the current financial year to maximise their tax deductions. However, they do not have enough surplus cash to prepay the interest on the entire \$100,000 loan balance.

James and Elizabeth’s adviser suggests they fix the interest rate and prepay the interest costs on \$60,000 only. The remaining \$40,000 will remain a variable rate loan, with the interest to be paid monthly in arrears.

Strategy snapshot

	Before strategy	After strategy
Interest claimed as tax deduction this financial year	12 months (all variable)	24 months, consisting of: <ul style="list-style-type: none"> ▶ 12 months variable interest, paid monthly in arrears (on \$100,000) ▶ 12 months fixed interest, paid annually in advance (on \$60,000)
Lump sum payment required before 30 June	None	12 months fixed interest on \$60,000
Interest payments next financial year	Monthly, variable interest rate	<ul style="list-style-type: none"> ▶ Monthly, variable interest rate on \$40,000 ▶ If the fixed rate loan continues beyond next year, they can adopt a similar strategy and pay their fixed interest in advance (on \$60,000) before 30 June next year

Advantages

- ▶ Greater interest rate certainty
- ▶ Brings some of the tax deduction forward to current financial year (if paid prior to 30 June)
- ▶ Total interest costs may decrease if the variable interest rate falls
- ▶ Improved management of cash flow, with a portion of the repayments fixed

Disadvantages

- ▶ Requires a lump sum interest payment (Note: you may be able to capitalise this amount to your loan so there’s no cash required)
- ▶ Total interest costs may increase if the variable interest rate rises
- ▶ Fixed interest rate may be higher than current variable rate
- ▶ Break fees may apply if fixed loan is broken early

Key features of a CommSec Adviser Services fixed rate investment loan

- ▶ Fixed rate terms from one year to five years.
- ▶ Competitive fixed interest rates.
- ▶ Choice of paying your interest in advance, or monthly in arrears.
- ▶ Fixed interest costs can be paid for in cash, or capitalised to the investment loan.
- ▶ Fixed loans may be terminated early. Some or all prepaid interest may be refundable (an Early Repayment Adjustment may apply for terminating a fixed loan early).

Why fix with CommSec Adviser Services?

CommSec Adviser Services has been looking after the borrowing needs of investors for over 15 years.

We are recognised as one of the leading providers of gearing solutions in Australia, and have received various prestigious awards over the years. CommSec Adviser Services products are provided by the Commonwealth Bank of Australia, one of the most recognised brands in the Australian financial services industry and a leading provider of integrated financial services.

Your next step

Talk to your financial adviser before 30 June to discuss your fixed interest rate options.

